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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943

No. 777

NORTHWEST BANCORPORATION,

Petitioner

V.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT, AND BRIEF IN SUPPORT THEREOF



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PETITION

Northwest Bancorporation prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Esgiph obscuit entered in this cause on February 16, 1944 (R. 46) reversing the decision of the Tax Court of the United States (R. 16-28).

QUESTIONS PRESENTED

1. Whether, as respects the credit by reason of contracts restricting the payment of dividends given by Section 26 (c) (1) of the Revenue Act of 1936 for purposes of the surtax on undistributed profits, the phrase "amounts which can be distributed" in said section includes only the taxpayer's

assets or whether it includes also shares of the taxpayer's own capital stock.

2. If the latter construction be correct, whether credit is to be denied under said provision where only one class of stock is authorized by the taxpayer's charter and it is provided by Section 115 (f) (1) of said Act that a non-taxable distribution "shall not be treated as a dividend".

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648: Sec. 14. Surtax on Undistributed Profits.

- (a) Definitions.—As used in this title—
 - (1) The term "adjusted net income" means the net income minus the sum of—
 - (A) The normal tax imposed by section 13.
 - (B) The credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.
 - (2) [as amended by Section 501 (a) (1) of the Revenue Act of 1942, c. 619, 56 Stat. 798] The term "undistributed net income" means the adjusted net income minus the sum of (A) the dividend paid credit provided in section 27, (B) the credit provided in section 26 (c) relating to restrictions on payment of dividends, (C) except in cases where section 26 (c) (1) is applicable, the deficit credit provided in section 26 (f), and (D) the redemption credit provided in section 26 (g).
- (b) Imposition of Tax.—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation a surtax equal to the sum of the following, subject to the application of the specific credit as provided in subsection (c):

7 per centum of the portion of the undistributed net

income which is not in excess of 10 per centum of the adjusted net income.

Sec. 26. Credits of Corporations.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

- (c) Contracts Restricting Payment of Dividends .-
 - (1) Prohibition on Payment of Dividends.—An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more credits are equal in amount only one shall be taken into account.
 - Disposition of Profits of Taxable Year.—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word "debt" does not include a debt incurred after April 30, 1936.

(3) Double Credit not Allowed.—If both paragraph (1) and paragraph (2) apply, the one of such paragraphs which allows the greater credit shall be applied; and, if the credit allowable under each paragraph is the same, only one of such paragraphs shall be applied.

Sec. 115.

(a) Definition of Dividend.—The term "dividend" when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

(f) Stock Dividends. **

(1) General Rule.—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be treated as a dividend to the extent that it does not constitute income to the shareholder within the meaning of the Sixteenth Amendment to the Constitution.

(h) Effect on Earnings and Profits of Distributions of Stock.—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities *** shall not be considered a distribution of earnings or profits of any corporation—

(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the meaning of the Sixteenth Amendment to the Constitution Regulations 94, promulgated under the Revenue Act of 1936: Art. 26-2.

- (b) Prohibition on payment of dividends.—The credit provided in section 26 (c) (1) is allowable only with respect to a written contract executed by the corporation prior to May 1, 1936, which expressly deals with the payment of dividends and operates as a legal restriction upon the corporation as to the amounts which it can distribute within the taxable year as dividends. If an amount can be distributed within the taxable year as a dividend—
 - (1) in one form (as, for example, in stock or bonds of the corporation) without violating the provisions of a contract, but can not be distributed within the taxable year as a dividend in another form (as, for example, in cash) without violating such provisions, or
 - (2) at one time (as, for example, during the last half of the taxable year), without violating the provisions of a contract, but can not be distributed as a dividend at another time within the taxable year (as, for example, during the first half of the taxable year) without violating such provision—

then the amount is one which, under section 26 (c) (1), can be distributed within the taxable year as a dividend without violating such provisions.

STATEMENT

The petitioner is a corporation organized under the laws of Delaware. Its principal place of business is in Minneapolis, Minnesota. It is engaged chiefly in owning and holding shares of common capital stock in banks and other financial institutions, and, in addition, in rendering to them various compensated supervisory services. One of such institutions is Union Investment Company. (R. 17.)

On December 30, 1933, the petitioner and Union executed

an agreement in consideration of a loan to Union by Reconstruction Finance Corporation, and of the purchase by RFC of shares of preferred stock or capital notes or debentures in certain banks in which the petitioner owned common shares; such banks were in the agreement referred to as "unit banks". (R. 17-18.) The agreement contained the following paragraph (R. 19):

Fifth. Northwest Bancorporation will not, without the prior written consent of RFC, declare or pay any dividends (except stock dividends) upon any of its outstanding shares of capital stock unless and until:

(C) the sound value of the assets representing the Common Capital in each of the Unit Banks, determined as hereinbefore provided in Paragraph Third, shall be equal to at least 150 percent of the outstanding aggregate par value of the preferred stock, and/or the aggregate face amount of capital notes or debentures of each of the unit banks.

The loan and purchases were made, all of them on or before September 30, 1934. (R. 19-20.)

While the loan had been repaid in full and the purchased preferred shares and capital notes and debentures had to a substantial extent been retired by the end of 1936, such shares and obligations were still held by RFC in certain banks whose assets during 1936 were not of a value as great as that specified in condition (C) of Paragraph Fifth of the agreement. (R. 20, 22.) By letter dated December 9, 1936, RFC notified the petitioner, in answer to a written inquiry from the latter, that it withheld consent to the petitioner's paying any dividends. (R. 5-8, 23.)

During 1936 and 1937¹ the petitioner's authorized capital stock consisted only of 2,000,000 common shares, of which

¹At issue is 1937 as well as 1936, the respective amounts involved, exclusive of interest, being \$130,940.18 and \$73,718.84. (R. 16, 28.) While both years were before the Tax Court, it has been agreed that proceedings as to the later year shall be suspended until final decision has been rendered as to 1936.

1,679,501 shares were issued; of the latter a minimum of 92,453 and a maximum of 102,066 were held in the petitioner's treasury. The smallest number of shareholders during these years was 17,660, with individual holdings ranging from one share to 15,540 shares, the smallest maximum individual holding at any one time being 15,000 shares. (R. 20-21.)

For purposes of the surtax on undistributed profits, the petitioner in its return, by reason of the restriction imposed by Paragraph Fifth of the agreement of December 30, 1933, claimed a credit under Section 26 (c) (1) of the 1936 Act equal to its adjusted net income. The respondent disallowed the credit, on the ground that the contract did not prohibit payment of taxable stock dividends, and determined a deficiency accordingly. (R. 23-24, 10-12.) The Tax Court reversed, on the ground that the petitioner could have paid only non-taxable stock dividends and that ability to pay such dividends does not preclude allowance of the credit. 27-28.) The Circuit Court of Appeals in turn reversed the Tax Court, restoring the respondent's determination. 43.) However, it did so for reasons different from that of the respondent; it held that the credit was not allowable if the taxpayer could have paid any kind of stock dividend, whether taxable or not, and that, in any event, lack of authority to pay taxable stock dividends was due to the limitations of the taxpayer's charter, and hence was the result of a non-contractual prohibition within the doctrine of Helvering v. Northwest Steel Rolling Mills, 311 U. S. 46. (R. 35-42.)

SPECIFICATION OF ERRORS TO BE URGED

- 1. The Circuit Court of Appeals erred in holding that the phrase "amounts which can be distributed" in Section 26 (c) (1) of the Revenue Act of 1936 includes shares of the taxpayer's own capital stock.
- 2. The Circuit Court of Appeals erred in holding that the word "dividends" in said Section 26 (c) (1) includes non-taxable distributions of shares of the taxpayer's own capital stock.
- 3. The Circuit Court of Appeals erred in holding that where a contract provides that a corporation may not "pay any dividends (except stock dividends) upon any of its outstanding shares of capital stock" and the corporation has only one authorized class of capital stock, inability of the corporation to pay a dividend taxable to its shareholders is not the result of a prohibition imposed by "written contract executed by the corporation" within the meaning of said Section 26 (c) (1).
- 4. The Circuit Court of Appeals erred in reversing the decision of the Tax Court.

REASONS FOR GRANTING THE WRIT

1. The principal issue relates to the construction to be placed upon a United States tax statute, Section 26 (c) (1) of the Revenue Act of 1936, particularly the phrase "amounts which can be distributed *** as dividends". As such, it presents an important question of federal law which has not been, but should be, settled by this Court. It involves determination, first, whether the phrase refers only to asset-distributions—"dividends" in the commonly-understood meaning—, or whether it includes also distributions

of shares of the taxpayer's own capital stock. However, the latter interpretation, once adopted, raises the further question whether the phrase includes not only taxable stock-distributions but non-taxable ones as well, in view particularly of the fact that non-taxable stock-distributions are by Section 115 (f) (1) of the Act excluded from the technical definition of "dividends".

These questions have never been before this Court, and the course of the decisions in the lower courts indicates that their solution is not easy; indeed, the decision whose review is sought to points out (R. 39-40), so far as the second foregoing question is concerned, that the problem is a "formidable" one and that "there reasonably is room" for either of the opposing possible interpretations. There is need under the circumstances for a definitive construction by this Court.

2. It appears further that the Circuit Court of Appeals may have misinterpreted and misapplied this Court's decision in *Helvering* v. *Northwest Steel Rolling Mills*, 311 U. S. 46, a case involving Section 26 (c) (1). Therein it was said (p. 49):

True, obligations not set out at length in a written contract may be incorporated by specific reference, or even by implication. But Congress indicated that any exempted prohibition against dividend payments must be expressly written in the executed contract. ***

Notwithstanding that it was spoken in a case wherein there was no written contract within the meaning of Section 26 (c) (1), whereas the contrary is true in the present cause, the foregoing language was by the Circuit Court of Appeals interpreted (R. 41-42) as requiring it to hold that there was at bar no contractually-imposed prohibition upon the petitioner's payment of taxable stock dividends inasmuch as the contract drew no distinction between taxable and non-

taxable stock dividends, and lack of authority to pay the former became evident only upon examination of the petitioner's charter. The court construed the *Northwest Steel* decision as forbidding looking outside the express terms of the contract for the purpose of ascertaining what was covered by the language used therein.

It does not seem reasonable to suppose that the Northwest Steel decision was intended by this Court to lay down any such extreme doctrine where, as here, the requirement of a written contract is satisfied. For otherwise it would mean that had the contract at bar prohibited the payment of all dividends "except such stock dividends as are allowable under the debtor's charter", the courts would be helpless to determine the bounds of the exception. But if the courts could look at the debtor's charter in that case, they should be able to do so at bar; for the legal effect is the same, under the familiar rule that corporate contracts are to be read in the light of what is allowable under charter powers (McCormick v. Market National Bank, 165 U. S. 538, 550).2

3. The issue has been dealt with, from one angle or other and under varying facts, in more than a score of cases in the lower courts. While information is not available to us as to the number of cases now pending, it seems safe to assume that there are at least a half dozen. Pending before this Court on application for certiorari as No. 644 is Valentine-Clark Corporation v. Commissioner (C. C. A. 8th), 137 F. (2d) 481. Pending on appeal to the Circuit Court of Appeals for the Seventh Circuit is Northwestern Steel & Wire Co. v. Commissioner, 1 T. C. 1114. It has been announced that the Government will appeal from the decision in Bates Valve Bag Corp. v. Higgins (D. C. N. Y.), to be found at

²The Circuit Court of Appeals appears (R. 42) to have regarded the tax-payer's charter as not a part of the contract "by legal implication". This seems to conflict with what is said in the *McCormick* case and in the first sentence of the quotation made above from the *Northwest Steel* decision.

434 Commerce Clearing House, par. 9530, wherein, under facts legally parallel with those in the present cause, it was held that credit was allowable. We understand also that an appeal on the part of the taxpayer is likely in Kaufmann Department Stores Securities Corp. v. Commissioner, 2 T. C. 656, wherein, again under facts legally parallel with those in the present cause, the Tax Court came to a conclusion directly contrary to its conclusion in the present cause, and held that credit was not allowable.

4. While it appears that at present the only decision in conflict with the decision sought to be reviewed is that in the Bates Valve case, there has until recently been a continuing and persistent conflict between the view of the Tax Court and the view of the Circuit Court of Appeals for the Eighth Circuit. What is more important, however, is that the decided cases indicate quite clearly considerable diffidence and uncertainty on the part of the courts, if indeed they have not been guilty of floundering.

The issue was first dealt with by the Tax Court, which adopted and for a considerable period adhered to the view that credit is allowable though stock dividends are not prohibited if the taxpayer had charter authority to pay only no taxable stock dividends. See Paraport Theatre Leasing Corporation v. Commissioner, 44 B. T. A. 108, and other cases cited in the Tax Court's opinion in this cause. (R. 26.) The Tax Court continued in this view until Oregon Pulp & Paper Co. v. Commissioner, 47 B. T. A. 772, in which it veered toward the contrary position.3 Six months later, however, it

On the very same day the Valentine case was decided the Tax Court came to an opposite conclusion in another case. Oswego Falls Corporation v. Commissioner, 46 B. T. A. 801, reversed on other grounds. Commissioner v. Oswego Falls Corporation (C. C. A. 2d), 137 F. (2d) 173. The opinions were of course written by different judges.

³The Tax Court had previously taken the contrary position in *Valentine-Clark Corporation* v. *Commissioner*, 46 B. T. A. 821. However, this was probably due to inadvertent oversight of the circumstance that all the taxpayer's authorized stock was outstanding. This fact was referred to in the Tax Court's findings (p. 825) but was not mentioned in its opinion.

decided the instant cause and therein swung back to its original view. (R. 28.) This was but momentary, however, for two months thereafter, in *Northwestern Steel & Wire Co.* v. *Commissioner*, supra, it shifted again to the view taken in the *Oregon* case.

That the Tax Court was still uncertain as to what position it would finally take is evidenced by the fact that its opinion in the Northwestern Steel & Wire case did not indicate express disagreement with the Tax Court's original decisions; nor did the opinion in the Oregon case do so. Express overruling of the original decisions came on September 9, 1943, in the Kaufmann case, supra, wherein the Tax Court said that it had concluded to adopt the view of the Circuit Court of Appeals for the Eighth Circuit.⁴

The issue has been before the Circuit Court of Appeals for the Eighth Circuit three times—in United States v. Dakota Tractor & Equipment Co., 125 F. (2d) 20, certiorari denied, 316 U. S. 671, in Valentine-Clark Corporation v. Commissioner, supra, and in the present cause. The Tax Court until its Kaufmann decision repeatedly expressed disagreement with the Dakota decision (see R. 27-28), and in its Valentine opinion the Eighth Circuit itself said (p. 484) that it was "not concerned here *** with the reasons advanced" in support of its decision in the Dakota case, thus in effect, if not expressly, repudiating the grounds for its original view. Moreover, the reasoning advanced in the instant case is quite different from that upon which the Valentine decision was rested. (Cf. 137 F. (2d) 483, the full paragraph in the second column, with R. 38-42.) Thus while the Eighth Circuit has been consistent as to result, it has regularly shifted ground in reaching that result.

⁴It is not entirely clear even now that the vacillation of the Tax Court is at an end. The *Kaufmann* decision is not a "reviewed" decision (see Section 1118 (b) of the Internal Revenue Code), and hence there may be room for doubt as to whether it represents the view of a majority of the Tax Court judges.

The precise issue has been before the Circuit Courts of Appeals in only one other case. Commissioner v. Columbia River Paper Mills (C. C. A. 9th), 127 F. (2d) 558. While the same result was reached as in the Dakota case, which was not mentioned, the principal ground advanced appears to be quite different from that given in any of the Eighth Circuit decisions; the right to a credit, the court said (p. 560), depends on whether the taxpayer is able to reduce its accounting surplus.

The vacillation and uncertainty revealed by the decided cases emphasizes the need for a definitive construction of the statute by this Court.

5. There are persuasive reasons for believing that the decision of the Circuit Court of Appeals may be in error, as that court itself acknowledges. The principal reasons are set out in the brief in support submitted herewith.

Wherefore it is respectfully submitted that the petition should be granted.

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BRIEF IN SUPPORT OF PETITION OPINIONS BELOW

The opinion of the Tax Court (R. 16-28) is not officially reported. The opinion of the Circuit Court of Appeals for the Eighth Circuit is not yet officially reported but may be found in 444 C. C. H. par. 9213.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered February 16, 1944. (R. 43.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED, STATUTES INVOLVED, ETC.

A statement of the questions presented, specification of errors, a statement of the case, and the statutes and regulations involved are set out in the petition.

ARGUMENT

The Statutory Phrase "Amounts Which Can Be Distributed" Does Not Include the Taxpayer's Own Capital Stock

First. The purpose of a contract prohibiting payment of dividends is to provide security for creditors or others holding obligations prior to the claims of shareholders. The creditor of a corporation is not normally concerned with whether his debtor distributes shares of its capital stock, for any claims thereby accruing are subordinate to his own, and hence share-distributions are usually not prohibited in such contracts.

For this reason an interpretation of the statutory phrase as including share-distributions leaves little if anything upon which the statute can operate, and violates the oft-reiterated rule that, where another interpretation is reasonably possible, a statute should not so be construed as to deprive it of all practical utility and leave it a nullity.

Second. The Circuit Court of Appeals in this cause assumed (R. 38-39) that it was called upon to construe the word "dividends". This is error; the critical word is "amounts", and this refers to earnings and profits.

"Amounts of earnings and profits" is the phraseology used in subdivision (2) of Section 26 (c), which is in pari materia with subdivision (1), the provision here in issue, since, as their common title "Contracts Restricting Payment of Dividends" indicates, the two "deal with precisely the same subject matter" (United States v. Stewart, 311 U. S. 60, 64), namely, the allowance of credit by reason of restrictive contracts. "Earnings and profits" in subdivision (2) can be represented only by the corporate debtor's property; it is only that, not the power to declare stock dividends, which can discharge indebtedness. Similarly, "amounts" in subdivision (1) can be represented only by the corporate

debtor's property; for earnings are retained for the security of creditors, not by failure to declare stock dividends, but only when the corporation's property is not distributed.⁵

Third. Legislative history supports the construction urged by the petitioner. As originally proposed, Section 26 (c) (1) provided for a credit only if there was "no form in which dividends" could be paid. H. R. 12395, Section 15 (a), 74th Cong., 2nd Sess. It was changed to its present language on the floor of the Senate. 80 Cong. Rec. 9071. In explaining the change, Senator LaFollette, one of the Conference Managers on the part of the Senate, said that the new provision was "a much broader and more liberal" one than that originally proposed. 80 Cong. Rec. 10470. The only possible liberalization of any substantial consequence was to remove the condition that credit was allowable only if there was "no form" in which dividends could be paid."

Furthermore, in explaining one of the amendments of Section 26 made by Section 501 (a) of the Revenue Act of 1942, the Senate Committee on Finance explained in its report that the purpose was to afford relief to certain corporate taxpayers which did not have "sufficient assets" to make distributions permitting escape from the surtax on undistributed profits. S. Rep. 1631, 77th Cong., 2nd Sess., p. 245.

Even if "dividends" rather than "amounts" be deemed the critical word, it should be construed to include only asset-distributions, for only so can the usefulness of the statute be preserved. That is the commonly-understood meaning of the word, its "business" sense. That is the sense in which the word has many times been employed by this Court. See Lynch v. Hornby, 247 U. S. 330, 346.

In this connection it may be observed that the Circuit Court of Appeals in this cause departed from the technical definition of dividends by reading into Section 26 (c) (1) that part of the statutory definition contained in subdivision (a) of Section 115 but not that part contained in subdivision (f) (1) of the same section. (R. 39-40.) If "dividends" is not to be given its technical meaning, then it ought to be given its business meaning; there is neither logic in nor occasion for taking a middle ground and working out a sort of hybrid.

[&]quot;In his brief in opposition in the Valentine-Clark case (No. 644) the respondent suggests (p. 10, note 1) that the liberalization referred to by the Senator may have been the substitution of the date May 1, 1936, for the date March 3, 1936. It taxes one's credulity to believe that this is what made the substituted provision "much broader and more liberal" than the original provision.

"Assets" clearly means property, and if "amounts which can be distributed" be not limited to asset-distributions, the enactment of the 1942 amendment was quite pointless.

Fourth. There are practical considerations which lend persuasive support to the petitioner's interpretation of the statute. Illustrative is the fact that, under the view of the Circuit Court of Appeals, in order to avoid the surtax the petitioner would have been compelled to give notice to not less than 17,660 shareholders, hold a special meeting of shareholders, induce them to consent to amendment of the charter so as to create a class of preferred stock, distribute 3,600 of the new shares assuming a \$100 market value per share (about 1/44 of a share of the new stock on each old share, or about 1/5 of a share on an average to each shareholder), and do such other numerous things, large and small, as are incident to a recapitalization.

Nor would that have been sufficient. Since the distribution of preferred shares would not have disturbed the proportionate interests of the shareholders, the new shares would not have been taxable. Helvering v. Sprouse, 318 U. S. 604. And so the petitioner would have been compelled, in advance of the distribution, either to make a gift to outsiders of some of the newly-authorized shares (which would have been unlawful) or, subject to the provisions of the Securities Act of 1933 and of applicable state securities laws, to shop around for buyers (for whose capital it probably would have had no profitable use).

Nor would all this have sufficed if, as might well have been the case, the petitioner's income had been represented by capital gains realized so late in the year as to have made such a program as the foregoing impossible of consummation before the end of the taxable period.

Pertinent under the circumstances is what this Court said in Woolford Realty Co. v. Rose, 286 U. S. 319, 329:

Doubt, if there can be any, is not likely to survive a consideration of the mischiefs certain to be engendered by any other ruling. ***

In Any Event, the Statutory Phrase "Amounts Which Can Be Distributed" Does Not Include Non-Taxable Stock Distributions

We have pointed out that the critical word is "amounts", not "dividends". Were it otherwise, however, the result should nevertheless be the same.

If "dividends" as used in Section 26 (c) (1) is not to be understood in its "business" sense as denoting only asset-distributions, it seems that the only logical alternative is to accept it as defined technically in the Act. The technical definition is contained in Section 115, subdivision (a) of which defines "dividends" as meaning any distribution out of earnings and profits, and subdivision (f) (1) of which excepts therefrom non-taxable stock distributions.

However, while rejecting the "business" definition for purposes of Section 26 (c) (1), the Circuit Court of Appeals did not accept the technical definition, at least not in full. Instead, in connection with the altogether questionable statement that that part of the definition appearing in subdivision (a) of Section 115 includes non-taxable as well as taxable stock distributions, it concluded that in construing "dividends" in Section 26 (c) (1), no regard should be had for that part of the definition contained in subdivision (f) (1) of Section 115. (R. 39-40.)

The only justification advanced for this exciding of the definition is a theory that subdivision (f) (1) is of consequence only in respect of shareholders who receive stock dividends, not in respect of the corporations which pay them. (R. 40.) This theory is completely refuted by subdivision

⁷See note 5, supra.

(h) (2) of Section 115, which provides that non-taxable stock distributions do not reduce the paying corporation's earnings and profits. The clear consequence is that a non-taxable stock distribution is not an amount "which can be distributed *** as dividends" within the meaning of Section 26 (c) (1).

The Petitioner Was Prohibited by Contract from Making Non-Taxable Stock Distributions

This Court held in the Northwest Steel case that a corporate charter is not a "contract" within the meaning of that word as used in Section 26 (c) (1), and that therefore a prohibition against dividends existing only by reason of charter provision does not warrant allowance of credit under that section.

In the present cause there was such a contract as the statute requires. However, because it allowed stock dividends without discriminating in terms between taxable and non-taxable stock dividends, and because only upon examination of the petitioner's charter does it become apparent that the petitioner was not empowered to pay taxable stock dividends, the Circuit Court of Appeals held (R. 41-42) that there was no contractual prohibition against payment of such dividends within the meaning of Section 26 (c) (1) and that the case falls within the doctrine of the Northwest Steel decision.

^{**}The Circuit Court of Appeals supported its holding that ability to pay non-taxable stock dividends deprives the taxpayer of credit under Section 26 (c) (1) with the statement (R. 38, 40) that this accords with the administrative interpretation evidenced by Regulations 94, Art. 26-2, supra. This statement is correct only if it be assumed that the regulation uses the word "dividend" as having a meaning different from that given it by Section 115 (a) and (f) (1). There is no foundation for any such assumption. Indeed, the fact seems to be to the contrary; in the present cause, for example, the Commissioner did not deny the credit on the ground that the taxpayer could pay stock dividends, but on the ground (R. 12) that the taxpayer could pay "taxable" stock dividends.

⁹A discrimination which we venture to suggest no prohibitory contract has ever made.

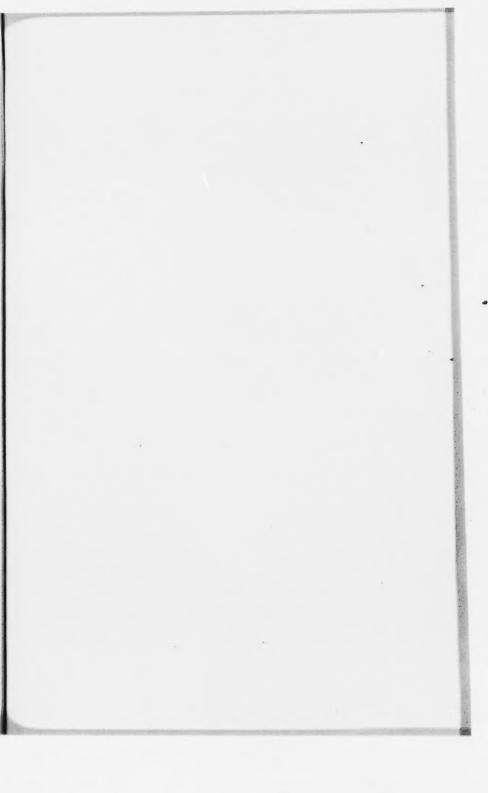
This is specious reasoning. Where a contract prohibits the payment of all dividends except stock dividends, both the prohibition and the exception are contractual. One looks outside the contract only to find the limits or meaning of the exception, and where share-distributions are excepted from the operation of the contract, it is to be presumed that the parties intended to except only such share-distributions as the corporation is otherwise legally authorized to make. The permissive grant is to be read as extending only to what may be done lawfully, not as extending to what the law does not allow.¹⁰

Respectfully submitted,

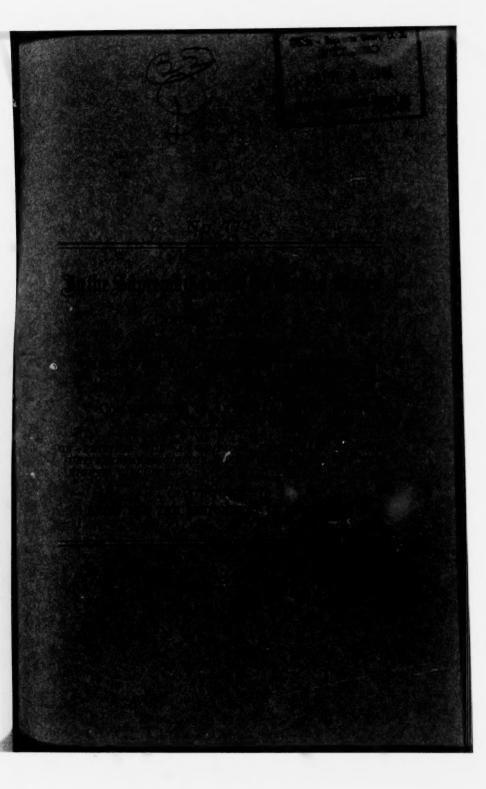
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FAEGRE & BENSON Of Counsel March 1944

¹⁰The Circuit Court of Appeals suggests (R. 37-38, 42) that there was in any event no factual or legal obstacle to payment of taxable stock dividends, on the ground that the corporation could have amended its charter. This is plain error: a corporation may not amend its charter; only the shareholders may do that.



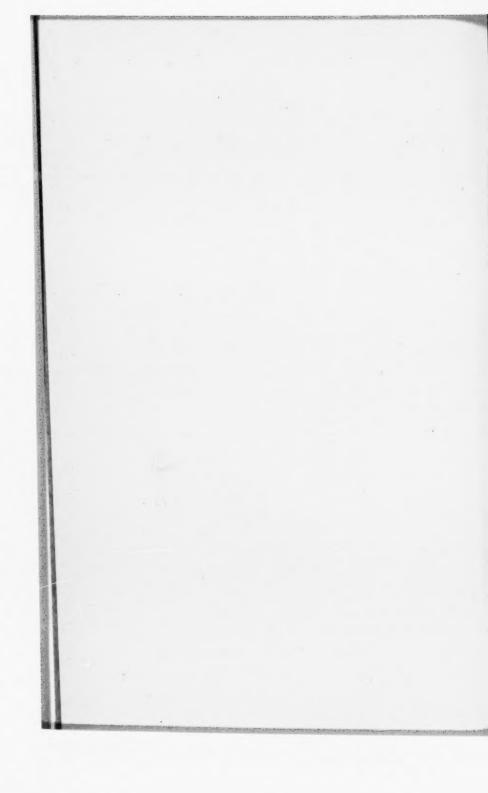






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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 777

NORTHWEST BANCORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The memorandum opinion of the Tax Court (R. 16-28) is unreported. The opinion of the Circuit Court of Appeals (R. 35-42) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 16, 1944. (R. 43.) The petition for a writ of certiorari was filed on March 10, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a contract prohibiting the payment of dividends, except stock dividends, was such a restriction upon dividend payments as to entitle the petitioner in the taxable year to the credit provided for in Section 26 (c) (1) of the Revenue Act of 1936.

STATUTES AND REGULATIONS INVOLVED .

The applicable statutes and regulations are printed in the Appendix, *infra*, pp. 12-20.

STATEMENT

The facts as found by the Tax Court (R. 17-25) may be summarized as follows:

The petitioner, a Delaware corporation with principal place of business in Minneapolis, Minnesota, is engaged in the business of owning and holding shares of common stock in banks and other financial institutions and in rendering supervisory services to such banks and institutions. One of these institutions was Union Investment Company [hereinafter referred to as Union], all of whose stock was owned by petitioner. (R. 17.)

On December 30, 1933, petitioner and Union executed a written contract in consideration of a loan of \$3,000,000 to Union by the Reconstruction Finance Corporation [hereinafter referred to as RFC] and the purchase by RFC of securities in banks owned by the petitioner (R. 17-18). The contract contained the provision that (R. 19):

Fifth. Northwest Bancorporation will not, without the prior written consent of RFC, declare or pay any dividends (except stock dividends) upon any of its outstanding shares of capital stock * * *

unless and until three conditions had been fulfilled. One of the three conditions was not complied with in 1936 and 1937, and RFC refused its consent to the payment of dividends in those years (R. 19-20, 22, 23).

During 1936 and 1937 the number of shares of petitioner's capital stock which were authorized was 2,000,000 and the number issued was 1,679,-501. During such years the greatest and smallest numbers of shares held in petitioner's treasury at any one time were 102,066 and 92,453, respectively. The smallest number of shareholders at any one time during 1936 and 1937 was 17,660; the smallest number of shares held by any one stockholder was one share and the greatest number of shares held by any one stockholder was 15,540. Petitioner's capital stock was listed and dealt in on the Chicago Stock Exchange in 1936 and 1937. (R. 20-21.) Prior to 1932 its stock consisted of common stock of a par value of \$50 per share. After October, 1932, petitioner's stock was of no par value (R. 25).

¹ The surtax liability of petitioner for the year 1936 only is involved in this petition for certiorari. However, it was stipulated before the Circuit Court of Appeals that the right to a dividend restriction credit in 1937 would be controlled by the final decision in this case.

Petitioner's surplus per books on December 31, 1936, was \$21,550,749.11 and on December 31, 1937, was \$22,632,341.19 (R. 21). Its earnings or profits before federal income taxes were \$359,604.15 for 1936 and \$627,492.96 for 1937 (R. 22).

Petitioner's bylaws provide that dividends on its capital stock "may be paid in cash, in property or in shares of the capital stock" (R. 22).

Petitioner paid dividends from the time of its organization until January 1, 1933. It paid no dividends from January 1, 1933, to November 25, 1939. Since the latter date it has paid dividends regularly. (R. £4.)

Upon the basis of the foregoing facts the Tax Court held that although the contract of December 30, 1933, expressly permitted the payment of stock dividends, the petitioner was entitled to a credit under Section 26 (e) (1) of the Revenue Act of 1936, because the only stock dividends which the petitioner could have paid under its existing capitalization would have been nontaxable The Circuit to the stockholders (R. 25-28). Court of Appeals reversed on the grounds that to comply with Section 26 (c) (1) the contract must prohibit the payment of dividends in all forms, including both taxable and nontaxable stock dividends; or if Section 26 (c) (1) should be construed as requiring a contractual prohibition against taxable stock dividends only, no credit was allowable in any event since a restriction on the payment of taxable stock dividends was not found in the provisions of the written contract (R. 36-42).

ARGUMENT

In computing the surtax imposed upon a corporation by Section 14 of the Revenue Act of 1936 (Appendix, *infra*), a credit is allowed by Section 26 (c) (1) of that Act (Appendix, *infra*) of—

An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends.

This case presents the question of whether the petitioner is entitled to such a credit by reason of its contract of December 30, 1933, which expressly permitted it to pay stock dividends.

The decision of the court below holding that Section 26 (c) (1) requires a contractual prohibition against dividends in all forms and not merely against asset distributions is in accord with United States v. Dakota Tractor & Equipment Co., 125 F. 2d 20 (C. C. A. 8th), certiorari denied, 316 U. S. 671; Commissioner v. Columbia River P. M., 127 F. 2d 558 (C. C. A. 9th); Commissioner v. Oswego Falls Corp., 137 F. 2d 173 (C C. A. 2d); and Valentine-Clark Corp. v. Commissioner, 137 F. 2d 481 (C. C. A. 8th),

pending before this Court on petition for writ of certiorari, No. 644. The administrative construction of the statute is to the same effect. Article 26-2 (b) of Treasury Regulations 94

(Appendix, infra).

This construction of the statute is also supported by decisions of this Court that Section 26 (c) (1) grants a special credit in the nature of a deduction and must be strictly construed against the taxpayer, who has the burden of showing that its contract comes within the exact statutory provisions (Helvering v. Northwest Steel Mills, 311 U. S. 46; cf. Helvering v. Ohio Leather Co., 317 U. S. 102).

Notwithstanding these decisions, the petitioner argues that Section 26 (c) (1) should not be construed as applying to stock dividends, or in fact to anything except asset distributions. The statute, however, is not so limited in terms and the petitioner cites no cases which would support such a construction. Instead, it relies on a statement made on the Senate floor as to a change in the provision there. The statement, however, is quite inconclusive on the question, and a construc-

² Section 15 (a) of H. R. 12395, as introduced in the Senate, provided: "If under a written contract executed by the corporation prior to March 3, 1936, there is no form in which dividends equal to the adjusted net income for the taxable year may be paid during the taxable year without violating a provision of such contract expressly dealing with the payment of dividends," the tax should be computed in a certain manner provided it did not increase the tax which would

tion of the word "dividends" to include stock dividends would seem to be in accord with the legislative purpose in enacting the undistributed profits tax law. See Commissioner v. Columbia River P. M., supra, p. 560. Section 27 of the same Act (Appendix, infra) is in pari materia, Section 27 being designed to grant credit for dividends actually paid and Section 26 (c) (1) being designed to give a credit to corporations which could not pay dividends because of a restrictive contract. Inasmuch as Section 27 makes specific provision for dividends payable in cash, in kind, in obligations of the corporation and for taxable and nontaxable stock dividends, Congress must have intended that Section 26 (c) (1), as a complementary section, should have the same scope, particularly as there is no limiting phrase in that section.3

otherwise be payable. The statement of Senator La Follette on the Senate floor that the Senate revision (which became Section 26 (c) (1) of the Revenue Act of 1936) was a more liberal provision may well be explained by the fact that the critical date for entering into contracts restricting dividends was extended to May 1, 1936. The significance of the earlier date was that it was the date on which the President sent a message proposing that a tax be levied on the undistributed profits of corporations. H. Rep. No. 2475, 74th Cong., 2d Sess., pp. 1–3 (1939–1 Cum. Bull. (Part 2) 667–669).

³ There is no merit to the contention that a statement in S. Rep. No. 1631, 77th Cong., 2d Sess., p. 245 (1942–2 Cum. Bull. 504) referring to "sufficient assets", shows that Congress intended the term "dividends" in Section 26 (c) (1) to mean only asset distributions. Section 501 (a) of the Revenue Act of 1942 amends Section 26 of the Revenue Act of 1936 to

Alternatively, petitioner argues that if Section 26 (c) (1) be construed to apply to stock dividends, its scope should be limited to taxable stock dividends. This contention is contrary to United States v. Dakota Tractor d' Equipment Co., supra, and there are no appellate court decisions in petitioner's favor. Section 115 (f) (1) of the Revenue Act of 1936, which petitioner cites, does not limit the general definition of dividend in Section 115 (a) (Appendix, infra), but merely prescribes that stock dividends may be subject to tax in the hands of shareholders to the extent that the Constitution permits, in contrast with the language of earlier statutes providing that they should not be taxed at all. See Helvering v. Griffiths, 318 U.S. 371, 380-383; H. Rep. No. 2475, 74th Cong., 2d Sess., p. 10 (1939-1 Cum. Bull. (Part 2) 667, 674); S. Rep. No. 2156, 74th Cong., 2d Sess., pp. 18-19 (1939-1 Cum. Bull. (Part 2) 678, 690). is nothing to indicate that the term "dividend" in Section 26 (c) (1) has any narrower meaning than the general definition of dividend set out in

provide for credits in the cases of deficit corporations prohibited by state law from paying dividends and corporations required by contract to use earnings in redemption of preferred stock. The reference in the Senate Report to "sufficient assets" relates to these new credits and has no bearing on the meaning of Section 26 (c) (1) of the Revenue Act of 1936.

⁴ Bates Valve Bag Corp. v. Higgins (S. D. N. Y.), decided June 23, 1943 (1943 P-H, par. 62,734), supports the petitioner, but this case is pending on the Government's appeal before the Circuit Court of Appeals for the Second Circuit.

Section 115 (a). That the language in Section 115 (a) is broad enough to include all stock dividends is clear from *Eisner* v. *Macomber*, 252 U. S. 189.

But even if Section 26 (c) (1) be construed as petitioner contends, the decision below is correct, The petitioner's contract contains no restriction against the payment of taxable stock dividends, but on the contrary expressly permits stock dividends, taxable or otherwise, to be paid. As evidence of its inability to pay taxable stock dividends, petitioner would import into the contract its certificate of incorporation, which authorizes only one class of stock, and the general law with respect to taxability of stock dividends. But the rule is settled that the restriction must be expressly written in the executed contract and may not be pieced out by other documents, not expressly or impliedly a part of the contract (Helvering v. Northwest Steel Mills, supra; Commissioner v. Columbia River P. M., supra). The certificate of incorporation was not a written contract within the meaning of Section 26 (c) (1) (Helvering v. Northwest Steel Mills, supra) and it was neither expressly nor by implication incorporated in the written contract in this case.

Petitioner concedes that there is no conflict in the cases (except for the one District Court case referred to above, which has been appealed), but it indicates that there has been considerable uncertainty in Tax Court decisions on this question and that clarification is needed. Such uncertainty would not constitute a basis for certiorari; but even if it would, the Tax Court in its latest decisions has followed the Circuit Courts of Appeals in holding that the restriction must be one effected by the contract alone and not by extrinsic conditions. Any previous vacillation on the part of the Tax Court, therefore, seems now to have been stilled. See Kaufmann Department Stores Securities Corp. v. Commissioner, 2 T. C. 656, pending on review (C. C. A. 3d); Northwestern Steel & Wire Co. v. Commissioner, 1 T. C. 1114, pending on review (C. C. A. 7th); Oregon Pulp & Paper Co. v. Commissioner, 47 B. T. A. 772.

In any event, if facts outside the contract are properly to be considered, they fail to show that the petitioner was prohibited from paying a taxable stock dividend. It had both net income and earned surplus in the taxable year which were available for transfer to capital account upon issuance of stock dividends (R. 21, 22). And although only one class of stock was authorized, under the law of Delaware (Appendix, infra) petitioner could have changed its capital structure to provide for other classes of stock, so that it would have been in a position to pay a taxable stock dividend. To the petitioner's suggestion that amendment of its charter might have been impracticable, it may be observed that the peti-

tioner had altered its capital structure twice before in its corporate history (R. 13-16) and further alterations would not seem to be beyond the limits of practicability. However, we submit that the provisions of the contract alone should be decisive of the issue, and that the contract here did not prohibit the distribution of stock dividends, taxable or otherwise.

CONCLUSION

The decision of the court below is correct and the petition for writ of certiorari should be denied.

Respectfully submitted.

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Special Assistants to the

Attorney General.

APRIL 1944.

APPENDIX

Revised Code of Delaware (1935), c. 65, Corporations:

> 2058. Sec. 26. Certificate of Incorporation: How Amended: When Corporation Has Capital Stock: When Corporation Has No Capital Stock.—Any corporation of this State existing prior to the tenth day of March, 1899, whether created by Special Act; or general law, or any corporation created under the provisions of this Chapter, may, from time to time, when and as desired, amend its Certificate of Incorporation by addition to its corporate powers and purposes, or diminution thereof, or both; or by substitution of other powers and purposes, in whole or in part, for those prescribed by its Certificate of Incorporation; or by increasing or decreasing its authorized capital stock or reclassifying the same, by changing the number, par value, designations, preferences, or relative, participating, optional, or other special rights of the shares, or the qualifications, limitations or restrictions of such rights. or by changing shares with par value into shares without par value, or shares without par value into shares with par value either with or without increasing or decreasing the number of shares; or by changing its corporate title; or by making any other change or alteration in its Certificate of Incorporation that may be desired, and any or all such changes or alterations may be effected by one certificate of amendment:

provided that every Certificate of Incorporation as so amended, changed or altered, shall contain only such provisions as it would be lawful and proper to insert in an original Certificate of Incorporation made at the time of making such amendment.

Whenever issued shares having par value are changed into the same or a greater or less number of shares without par value, whether of the same or of a different class or classes of stock, the aggregate amount of the capital of the corporation represented by such shares without par value shall be the same as the aggregate amount of capital represented by the shares changed; and whenever issued shares without par value are changed into other shares without par value to a greater or less number, whether of the same or of a different class or classes, the amount of capital represented by the new shares in the aggregate shall be the same as the aggregate amount of capital represented by the shares so changed. The certificate of amendment of any Certificate of Incorporation effecting any change in the issued shares of the corporation shall set forth that the capital of the corporation will not be reduced under or by reason of said amendment.

Every such amendment shall be made and effected in manner following, to-wit:

1. If the corporation has a capital stock, its Board of Directors shall adopt a resolution setting forth the amendment proposed, declaring its advisability, and calling a meeting of the stockholders entitled to vote in respect thereof, for the consideration of such amendment. Said meeting shall be called and held upon such notice as the certificate of incorporation or by-

laws of the corporation shall provide, or, in the absence of such provision, upon notice thereof to each stockholder so entitled to vote, either delivered to such stockholder or mailed to him, at his postoffice address, if known, at least ten days before the date fixed for said meeting, said notice to set forth such amendment in full or a brief summary of the changes to be effected thereby, as the Directors shall deem advisable. At said meeting a vote of the stockholders so entitled to vote, by ballot, in person or by proxy, shall be taken for and against the proposed amendment, which vote shall be conducted by two Judges appointed for the purpose, either by the directors or by the said meeting. Said Judges shall decide upon the qualifications of voters and accept their votes, and when the vote is completed, count and ascertain the number of shares voted respectively for and against the amendment, and shall declare whether the persons or bodies corporate holding the majority of the voting stock of said corporation (or of each class of stock entitled to vote thereon, when such vote is to be taken by classes) have voted for or against the proposed amendment; and shall make out a certificate accordingly, stating the number of shares of stock, issued and outstanding and entitled to vote thereon, and the number of shares voted for and the number of share's voted against the amendment respectively, and shall subscribe and deliver said certificate to the Secretary of the corporation. If it shall appear by said Certificate of the Judges that the persons or bodies corporate holding the majority of the stock of said corporation entitled to

vote (or of each class of stock when such vote is to be taken by classes) have voted in favor of the amendment, a certificate setting forth the amendment and certifying that such amendment has been duly adopted in accordance with the provisions of this Section shall be made under the seal of the corporation and signed by its President or a Vice-President, and its Secretary or an Assistant Secretary and the President or such Vice-President shall acknowledge the said certificate before an officer authorized by the laws of Delaware to take acknowledgments of deeds; and the said certificate, so executed and acknowledged shall be filed in the office of the Secretary of State, and a copy thereof, certified by said Secretary of State, shall be recorded in the office of the Recorder of the County in which the original Certificate of Incorporation is recorded; or if the corporation shall have been created by special public act of the Legislature, then said certificate shall be recorded in the office of the Recorder of any County where the business of the said corporation may be conducted. And upon so filing and recording the same, the Certificate of Incorporation of said corporation shall be deemed to be amended accordingly; provided, however, that if any such proposed amendment would alter or change the preferences, special rights or powers given to any one or more classes of stock, by the Certificate of Incorporation, so as to affect such class or classes of stock adversely, or would increase or decrease the amount of the authorized stock of such class or classes of stock, or would increase or decrease the par value thereof, then the holders of the stock of each class of stock so affected by the amendment shall be entitled to vote as a class upon such amendment, whether by the terms of the Certificate of Incorporation such class be entitled to vote or not: and the affirmative vote of a majority in interest of each such class of stock so affected by the amendment shall be necessary to the adoption thereof, in addition to the affirmative vote of a majority of all other stock entitled to vote thereon; and provided, further that the amount of the authorized stock of any such class or classes of stock may be increased or decreased by the affirmative vote of the holders of a majority of the stock of the corporation entitled to vote, if so provided in the original Certificate of Incorporation or in any amendment thereto which created such class or classes of stock or in any amendment thereto which was authorized by a resolution or resolutions adopted by the affirmative vote of the holders of a majority of such class or classes of stock.

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 14. SURTAX ON UNDISTRIBUTED PROFITS.

(a) Definitions.—As used in this title—

(1) The term "adjusted net income" means the net income minus the sum of—

(A) The normal tax imposed by section 13.

(B) The credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

(2) The term "undistributed net income" means the adjusted net income minus the

sum of the dividends paid credit provided in section 27 and the credit provided in section 26 (c), relating to contracts re-

stricting dividends.

(b) Imposition of Tax.—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation a surtax equal to the sum of the following, subject to the application of the specific credit as provided in subsection (c):

7 per centum of the portion of the undistributed net income which is not in excess of 10 per centum of the adjusted net income.

12 per centum of the portion of the undistributed net income which is in excess of 10 per centum and not in excess of 20 per centum of the adjusted net income.

17 per centum of the portion of the undistributed net income which is in excess of 20 per centum and not in excess of 40 per centum of the adjusted net income.

22 per centum of the portion of the undistributed net income which is in excess of 40 per centum and not in excess of 60 per centum of the adjusted net income.

27 per centum of the portion of the undistributed net income which is in excess of 60 per centum of the adjusted net income.

Sec. 26. Credits of corporations.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

(c) Contracts Restricting Payment of Dividends.—

(1) Prohibition on payment of dividends.—An amount equal to the excess of

the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more credits are equal in amount only one shall be taken into account.

Sec. 27. Corporation credit for dividends PAID.

(a) Dividends Paid Credit in General.— For the purposes of this title, the dividends paid credit shall be the amount of dividends paid during the taxable year.

(e) Taxable Stock Dividends.—In case of a stock dividend or stock right which is a taxable dividend in the hands of shareholders under section 115 (f), the dividends paid credit with respect thereto shall be the fair market value of the stock or the stock right at the time of the payment.

(h) Nontaxable Distributions.—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) Definition of Dividend.—The term "dividend" when used in this title (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 26-2. Credit in connection with contracts restricting payment of dividends.—

(b) Prohibition on payment of dividends.—The credit provided in section 26 (c) (1) is allowable only with respect to a written contract executed by the corporation prior to May 1, 1936, which expressly deals with the payment of dividends and operates as a legal restriction upon the corporation as to the amounts which it can distribute within the taxable year as dividends. If an amount can be distributed within the taxable year as a dividend—

(1) in one form (as, for example, in stock or bonds of the corporation) without violating the provisions of a contract, but can not be distributed within the taxable year as a dividend in another form (as, for

example, in cash) without violating such

provisions, or

(2) at one time (as, for example, during the last half of the taxable year) without violating the provisions of a contract, but can not be distributed as a dividend at another time within the taxable year (as, for example, during the first half of the taxable year) without violating such provision—then the amount is one which, under section 26 (c) (1), can be distributed within the taxable year as a dividend without violating

such provisions.

The credit provided in section 26 (e) (1) is equal to the excess of the adjusted net income, as defined in section 14 (a), over the aggregate of the amounts which can be distributed within the taxable year without violating the provisions of such contract. The requirement that the provisions of the contract expressly deal with the payment of dividends is not met in case (1) a corporation is merely required to set aside periodically a sum to retire its bonds, or (2) the contract merely provides that while its bonds are outstanding the current assets shall not be reduced below a specified amount.

